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November 5, 2004

The Honorable A.G. Kawamura, Secretary
California Department of Food and Agriculture
1220 N Street
Sacramento, CA 95814

Re: Dairy Institute Petition

Dear Mr. Secretary:

We respectfully request that you deny the Class 1 petition filed by the Dairy Institute of California. The justification they provide in this petition is essentially the same, yet masked, argument provided in the petition recently denied by the Department. The Dairy Institute argues, "Because of the disincentives built into the pricing formulas currently employed by the Stabilization and Marketing Plans for Market Milk, California processors actually have an incentive to purchase milk from more competitive sources."

As you will find, California's Class 1 prices are in reasonable relationship to surrounding areas. So really, at issue here is the "incentive to purchase milk from more competitive sources" which is not a direct effect of California's Class 1 prices being too high, but rather the way this more "competitive" milk is handled in the pool. This is a direct link to the current "Hillside-Ponderosa" litigation and the fact that out-of-state milk used for Class 1 purposes is credited at the Class 1 price and therefore essentially exempt from pool obligations. It is this situation, which was actually supported by the Dairy Institute in their filing of an amicus brief in support of the Hillside-Ponderosa plaintiffs against you as Secretary of CDFA, that makes this milk more "competitive," not the fact that California's Class 1 prices are too high.

Also, on a similar note, as you are aware, pursuant to Section 62062.1 of the Food and Agricultural Code, the Secretary may hold a hearing to consider adjustments to the Class 1 price if the statewide weighted average Class 1 price (on milk testing 3.5 fat and 8.7 solids not fat) paid to producers is found to not be in a reasonable relationship with the Class 1 prices paid to producers in contiguous states. We respectfully argue that a Class 1 hearing is not necessary at this time.

A comparison of Class 1 prices in California to that of contiguous orders below shows that California pricing is undoubtedly in a reasonable relationship to surrounding states. In fact, in 4 of the last 11 months, California's statewide Class 1 average has been below that of any surrounding area prices with an additional 4 months in which only one surrounding area (So. Nevada) was below our statewide average. When compared to surrounding orders, California Class 1 averages (Northern, Southern and Statewide) for the past 11 months fall below or are in-line with averages in nearby areas.

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Area	11-month Average (Jan 04- Nov 04)
Arizona Central, Phoenix, Tucson	\$17.38
Oregon, Western - Medford, Portland	\$16.93
Southern CA- Los Angeles	\$16.73
California-Statewide Average	\$16.59
No. CA - S.F., Nevada, Northwest, Reno, Winnemucca	\$16.46
Nevada, Southern - Las Vegas	\$16.43

As an additional comparison, the department has in the past released data which compares the Southern California Class 1 price to what would have been in effect if California were a federal order. "Under federal order reform, Class 1 differentials were established for all counties in California. If the differentials for all the counties in Southern California are averaged based on their Class 1 utilization, the resulting weighted average Class 1 differential is approximately \$2.07."¹ Though California was exempt from federal reform, if this comparison were to be used as a basis to adjust Class 1 prices in California, it should be noted that, on average, 2004 Southern California prices have been below the price that would have been established under federal reform. In fact, January-November 2004, the Class 1 differential, when compared to the federal order Class 1 base price, averaged approximately \$1.69, far below the estimated \$2.07 that would be in place under federal orders.

Concern has also been raised by the Dairy Institute over the competition from a nearby producer-distributor (PD) in Arizona capturing the Southern California Class 1 market. We too are concerned about the ability of this PD to undercut California processors to capture market share. However, it should be noted that this producer-distributor is unregulated. There is not a low enough California Class 1 price that can possibly compete with an unregulated processor who is not required to pay any specific price for the milk he acquires. We argue that federal legislation that imposes regulation on this PD is the only way to address this problem and, to this end, Western United Dairymen is lobbying collaboratively with the Dairy Institute to close this federal regulatory loophole. Lowering the California Class 1 price would not have any significant impact.

Furthermore, it is our understanding that on shipments of milk from California into federal orders, processors must pay the difference between the federal order Class I price and the California Class 1 price, when the California Class 1 price falls below the federal order Class I price. These payments are known as compensatory payments. Processors may argue that a lower Class 1 price is needed in California in order to compete with processors in surrounding states, particularly Southern Nevada. However, lowering the California Class 1 price will only exacerbate the problem since processors shipping into federal orders will be required to pay even larger compensatory payments. In fact, it is our understanding that a recent lawsuit has been filed by the Dairy Institute on this very matter. Once again, lowering the California Class 1 price is not the solution.

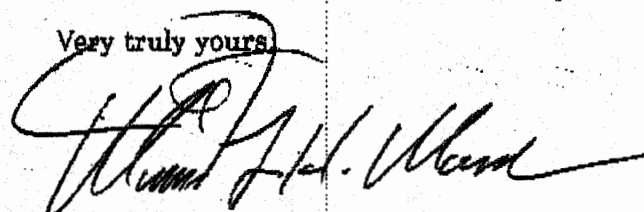
¹ Memo from Dairy Marketing Branch Dated August 30, 2001 explaining analysis conducted in the May 31, 2001 "Hearing Panel Report."

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All indications show that prices in California are not only in a reasonable relationship to surrounding states but are in most instances below prices in nearby states. Any reduction in Class 1 prices at this time would put producers in California at a disadvantage to producers in surrounding states. Furthermore, lower California Class 1 prices will not address the concerns behind the Dairy Institute's petition; the competitiveness of out-of-state milk and unregulated producer-distributors.

We greatly appreciate your attention to this matter and are sure you will find that there is no justification for a Class 1 hearing at this time.

Very truly yours,



Michael L. H. Marsh, CPA
Chief Executive Officer

cc: Kim Myrman, Deputy Secretary
Kelly Krug, Director, Marketing Services
David Ikari, Chief, Dairy Marketing Branch
Board of Directors, Western United Dairymen